

## Internal Revenue Service

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May 26, 2011

In re:

### Legend

Date 1	=
Trustor	=
Family Trust	=
Spouse	=
Individual	=
State	=
A	=
X	=
Y	=
Date 2	=
Date 3	=
Daughter 1	=
Daughter 2	=
Trust 1	=
Trust 2	=
Date 4	=
Receiving Trust	=
Family Entity	=

Dear :

This letter responds to your authorized representative's letter dated May 3, 2011, and prior correspondence, in which you request rulings concerning the income, gift, estate, and generation-skipping transfer (GST) tax consequences of the proposed transfer of assets of Trust 1.

The facts submitted and representations made are as follows:

On Date 1, a date after September 26, 1985, Trustor established Family Trust, an irrevocable trust, for the benefit of the descendants of Trustor and his wife, Spouse. Trustor was the initial trustee and Individual was the initial special trustee.

Pursuant to Article 2.5, unless terminated sooner by distribution of all trust assets, the Family Trust terminates on Trustor's death and all trust property will be divided into equal shares between the descendants of Trustor and Spouse (Descendant's Trust). Each such share will be distributed to the trustee of Descendant's Trust for the benefit of the descendant and his or her descendants. Descendant's Trust is to be administered pursuant to Article 3 of Family Trust.

Article 3.1.1 provides, in part, that the special trustee has sole discretion to direct trustee to distribute all or any part of the net income or principal (or both) to or for the benefit of all or any then living descendants of Trustor and Spouse (beneficiaries), or to one or more trusts for the primary benefit of any of the beneficiaries.

Article 3.1.2 provides, in part, that the special trustee cannot direct the trustee to make any discretionary distributions of Family Trust to the special trustee, any person who has served as the special trustee, or to a trust in which the special trustee or a prior special trustee has a beneficial interest.

Article 3.1.3 provides, in part, that if the descendant is alive when Descendant's Trust is initially funded, descendant shall have a special power of appointment over trust property exercisable only in favor of any one or more living descendants of Trustor and Spouse or trusts for the exclusive benefit of any one or more living descendants of Trustor and Spouse. If there are no living descendants of Trustor and Spouse, the power may be exercised in favor of any person, persons, trusts, or charities, other than the descendant's creditors, descendant's estate, or creditors of descendant's estate. However, any trust created by exercise of the descendant's special power of appointment cannot extend beyond the termination date of the Family Trust.

Article 3.2 provides, in part, that if not terminated sooner by distribution of all trust property, a descendant's trust shall terminate at the earlier of the death of the last surviving descendant of Trustor and Spouse, or the expiration of the State rule against perpetuities. If the last beneficiary to die is a descendant of Trustor and Spouse, the trustee shall distribute any property that has effectively been appointed by the descendant through the exercise of the special power of appointment. Any property not duly appointed by the descendant's special power of appointment shall be divided into shares, per stirpes, to the descendant's trust, if any, of the then living descendants of Trustor. The expiration of the State rule against perpetuities is determined as the later of A years from Date 1, and 21 years after the death of last to die of all descendants of X and Y living on Date 1.

Trust became irrevocable after September 25, 1985. It is represented that sufficient GST exemption was allocated to Family Trust so that Family Trust has an inclusion ratio of zero under § 2642.

On Date 2, Trustor resigned as managing trustee and, pursuant to Article 4.1 of the Family Trust agreement, Trustor appointed Spouse as successor managing trustee. Trustor died testate on Date 3, survived by Spouse, and his children, Daughter 1 and Daughter 2. In accordance with Article 2.5, separate trusts were created for the primary benefit of Daughter 1 and her descendants, Trust 1, and Daughter 2 and her descendants, Trust 2. Each of Trust 1 and Trust 2, which are governed by identical terms, held one-half of the assets held by Family Trust and retained the Family Trust's zero inclusion ratio for GST tax purposes under § 2642.

On Date 4, Daughter 2 died without descendants and without exercising her special power of appointment over the assets of Trust 2. Consequently, all assets held in Trust 2 passed to Trust 1 pursuant to Article 3.2. It is represented that other than the transfer upon Daughter 2's death, no additions have been made to Trust 1 since its initial funding. Accordingly, Trust 1 has retained a zero inclusion ratio for GST tax purposes.

Individual, as special trustee of Trust 1, desires to administer the various family entities, including Trust 1, in a consistent manner. As part of this effort, Individual proposes to direct Spouse, as managing trustee, to transfer the assets of Trust 1 into Receiving Trust, as is permitted under Article 3.1.1 of the Family Trust agreement.

The terms of the proposed Receiving Trust will be substantially similar to the terms of Family Trust. Receiving Trust provides as follows:

Spouse will remain as the managing trustee and Individual will remain as the special trustee of Receiving Trust. Receiving Trust is to be for the primary benefit of Daughter 1 and her later born or adopted descendants (Beneficiaries).

The special trustee has sole discretion to direct the managing trustee to distribute income or principal to or for the benefit of any then living Beneficiaries, or to one or more trusts for the benefit of any Beneficiary. However, if a distribution is made to a trust, the trust cannot extend beyond the termination date of Family Trust. Furthermore, if there is more than one special trustee appointed, their decisions must be unanimous, excluding the vote of any special trustee who is prohibited from participating in the action by other specific provisions of the trust.

The special trustee is prohibited from directing discretionary distributions to or for the present or future benefit of the special trustee, his estate, his creditors or the creditors of his estate, or any trust in which the special trustee, his estate, his creditors or the creditors of his estate has beneficial interest. Further, any special trustee who is

not an Independent Person, as defined in Article 2.3 of Receiving Trust, cannot participate in any distribution to or for the benefit of any Beneficiary who, directly or indirectly, in any way participated in the appointment of that person as special trustee.

There must be at least one Independent Person serving as special trustee if the trust holds any incident of ownership in Family Entity, or all other special trustees are prohibited from directing distributions to Daughter 1 or any other Beneficiary due to other specific provisions of the trust.

Article 2.3 of Receiving Trust provides, in part, that Independent Person is defined as any person or institution that is described under § 672(c) as a “related or subordinate party,” whether or not such person is “adverse” as defined in § 672(a).

Spouse and Daughter 1 each have the power to remove, or remove and replace, the special trustee and appoint one or more successor persons, other than Spouse, to act alone or jointly, as the special trustee. Any person appointed by Spouse to act as the special trustee must be an Independent Person as defined in Article 2.3.

Daughter 1 will continue to have a testamentary special power of appointment exercisable pursuant to the terms of Article 3.1.3 of Family Trust, however the duration of any trust created by Daughter 1’s exercise of her special power of appointment may not extend beyond the termination date of Receiving Trust.

If not terminated sooner by distribution of all trust property, Receiving Trust shall terminate at the earlier of the death of the last surviving descendant of Trustor, or January 1 of the 20<sup>th</sup> year after the death of the last to die of all descendants of X and Y living on Date 1.

You request the following rulings:

1. After the proposed transfer of assets from Trust 1 to Receiving Trust, Receiving Trust will retain a zero inclusion ratio for purposes of Chapter 13 of the Code;
2. No successor trustee or beneficiary of Receiving Trust will be considered to have a general power of appointment over the trust under §§ 2041 and 2514;
3. The proposed transfer of assets from Trust 1 to Receiving Trust will not result in a transfer by any beneficiary that is subject to gift tax under § 2501;
4. The proposed transfer of assets from Trust 1 to Receiving Trust will not result in any beneficiary recognizing income under § 61 or gain under § 1001; and

5. The proposed transfer of assets from Trust 1 to Receiving Trust will not result in any change in the basis or holding period of any trust assets as determined under §§ 1015 and 1223.

### Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 2602, the amount of tax imposed under § 2601 is determined by multiplying the taxable amount by the applicable rate. Under § 2641, the term “applicable rate” means with respect to any GST, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a GST is the excess (if any) of 1 over the applicable fraction. Under § 2642(a)(2), in general, the applicable fraction is a fraction the numerator of which is the amount of GST exemption allocated to the trust (or in the case of a direct skip allocated to the property transferred in such skip), and the denominator of which is the value of the property transferred to the trust (or direct skip).

Under § 2631(a), for purposes of determining the inclusion ratio every individual is allowed a GST exemption amount that may be allocated by the individual (or the individual’s executor) to any property with respect to which the individual is the transferor.

Section 26.2601-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(A) provides that the distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of chapter 13, if - (1) either (i) The terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or (ii) at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or

court; and (2) The terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.

Section 26.2601-1(b)(4)(i)(E), Example 1, considers a situation where, in 1980, Grantor established an irrevocable trust (Trust) for the benefit of Grantor's child, A, A's spouse, and A's issue. At the time Trust was established, A had two children, B and C. A corporate fiduciary was designated as trustee. Under the terms of Trust, the trustee has the discretion to distribute all or part of the trust income to one or more of the group consisting of A, A's spouse or A's issue. The trustee is also authorized to distribute all or part of the trust principal to one or more trusts for the benefit of A, A's spouse, or A's issue under terms specified by the trustee in the trustee's discretion. Any trust established under Trust, however, must terminate 21 years after the death of the last child of A to die who was alive at the time Trust was executed. Trust will terminate on the death of A, at which time the remaining trust principal will be distributed to A's issue, per stirpes. In 2002, the trustee distributes part of Trust's principal to a new trust for the benefit of B and C and their issue. The new trust will terminate 21 years after the death of the survivor of B and C, at which time the trust principal will be distributed to the issue of B and C, per stirpes. The terms of the governing instrument of Trust authorize the trustee to make the distribution to a new trust without the consent or approval of any beneficiary or court. In addition, the terms of the governing instrument of the new trust do not extend the time for vesting of any beneficial interest in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of Trust, extending beyond any life in being at the date of creation of Trust plus a period of 21 years, plus if necessary, a reasonable period of gestation. Therefore, neither Trust nor the new trust will be subject to the provisions of chapter 13.

The instant case involves facts that are similar to Example 1 in § 26.2601-1(b)(4)(i)(E) except that Family Trust was created and funded after September 25, 1985. The rules in § 26.2601-1(b)(4)(i) apply in the case of trusts that are exempt from GST tax because the trusts were in existence and irrevocable prior to September 25, 1985. It is represented that sufficient GST exemption was allocated to the Family Trust so that the trust has an inclusion ratio of zero under § 2642. Moreover, other than the Trust 2 assets passing to Trust 1 upon Daughter 2's death, it is represented that no additions have been made to Trust 1 since its initial funding. Accordingly, Trust 1 continues to retain a zero inclusion ratio for GST tax purposes. No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the

GST status of a grandfathered trust should similarly not affect the exempt status of such a trust.

The terms of Family Trust, which is the governing instrument of Trust 1, allow the special trustee to transfer Trust 1 assets to the trustee of any one or more other trusts for the primary benefit of any beneficiary, in this case Daughter 1. Receiving Trust contains provisions to ensure that the time for vesting of any beneficial interest does not extend beyond the time as provided under Family Trust.

Based on the facts presented and the representations made, we conclude that the distribution of assets from Trust 1 to Receiving Trust is pursuant to the terms of the governing instrument. Family Trust authorizes distributions of principal to new trusts without the consent or approval of any beneficiary or court. The terms of Receiving Trust will not extend the time for vesting of any beneficial interest in Receiving Trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.

Accordingly, based on the facts presented and the representations made, the transfer of Trust 1 assets to Receiving Trust will not alter the inclusion ratio of Receiving Trust for GST tax purposes so that, after the transfer Receiving Trust will have an inclusion ratio of zero under § 2642.

### Ruling 2

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

A general power of appointment is defined in § 2041(b)(1) as a power which is exercisable in favor of the decedent possessing the power, his estate, his creditors, or the creditors of his estate.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that if a trust instrument provides that the beneficiary may appropriate or consume the principal of the trust, the power to consume or appropriate is a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary

capacity, whereby the holder has no interest therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment.

Section 2514(c)(1) provides that a general power of appointment is a power that is exercisable in favor of the individual possessing the power (the possessor), his estate, his creditors, or the creditors of his estate.

Section 25.2514-1(b)(1) of the Gift Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power to remove or discharge a trustee and appoint himself. For example, if under the terms of the instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and A, another person, has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, A is considered as having a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

In Rev. Rul. 95-58, 1995-2 C.B. 191, the Service held that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate to the decedent within the meaning of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus is not included in the decedent's gross estate under § 2036 or § 2038. The ruling notes that the Eighth Circuit in Estate of Vak v. Comm'r, 973 F.2d 1409 (8th Cir. 1992), concluded that the decedent had not retained dominion and control over assets transferred to a trust by reason of his power to remove and replace the trustee with a party that was not related or subordinate to the decedent. Accordingly, the court held that under § 25.2511-2(c), the decedent made a completed gift when he created the trust and transferred assets to it.

Section 672(c) defines the term "related or subordinate party" to mean any nonadverse party who is (1) the grantor's spouse if living with the grantor; or (2) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

Under the proposed Receiving Trust, at the time of Daughter 1's death, she will have a testamentary power of appointment over the trust assets that cannot be exercised in favor of her estate, her creditors, or the creditors of her estate, provided that any appointee trust does not extend beyond the maximum term of Family Trust.



Accordingly, because Daughter 1's testamentary power of appointment cannot be exercised in favor of herself, her creditors, or the creditors of her estate, this power will not constitute a general power of appointment under §§ 2041 and 2514.

Under the terms of Receiving Trust, Spouse and Daughter 1 each hold the power to remove, or remove and replace, the special trustee. Although a special trustee has the authority to direct discretionary distributions from Receiving Trust to or for the benefit of any living beneficiaries, the special trustee is prohibited from directing distributions, directly or indirectly, to, or for the present or future benefit of himself, his creditors, or the creditors of his estate, or any trust in which any special trustee has a present or future beneficial interest. Furthermore, the terms of Receiving Trust prohibit any special trustee who is a "related or subordinate party" pursuant to § 672(c) from directing distributions, directly or indirectly, to, or for the present or future benefit of any beneficiary who, at any time, appointed or participated in the appointment of the special trustee. Consequently, only a special trustee who is not related or subordinate to a beneficiary is permitted to direct trust distributions to or for the present or future benefit of the beneficiary if the beneficiary participated in the special trustee's appointment.

If there are no special trustees empowered to direct trust distributions to any beneficiary due to the limitations imposed on special trustees, at least one person or institution who is not related or subordinate to the beneficiary will also serve as special trustee. The new independent special trustee holds sole discretion with regard to directing distributions to the beneficiary and the other special trustees are not able to prevent such distributions. Accordingly, based on the facts presented and the representations made, a beneficiary's powers to remove and replace the special trustee are not general powers of appointment under §§ 2041 and 2514.

### Ruling 3

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed a gift that is included in computing the amount of gifts made during the calendar year.

In the present case, all beneficial interests in trust assets will be the same before and after the proposed transfer to Receiving Trust. The proposed transfer of Trust 1 assets to Receiving Trust, as described above, will not result in any change in the beneficial interests of any of the trusts' beneficiaries. Accordingly, based on the facts presented and representations made, the transfer of assets from Trust 1 to Receiving Trust will not result in transfers of any beneficial interest that is subject to tax under § 2501.

#### Rulings 4 and 5

Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under § 61(a)(15), from an interest in a trust.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

In Cottage Savings Ass'n v. Comm'r, 499 U.S. 554 (1991), the Supreme Court ruled on the elements necessary to determine that, under § 1001, a sale or exchange resulting in realization of gain or loss had occurred. The Court held that realization under § 1001 required (1) a sale, exchange, or other disposition, and (2) in the case of an exchange, the receipt of property that was "materially different" from the property disposed of.

Therefore, because the transfer of assets from Trust 1 to Receiving Trust will be made under the authority granted to the special trustee under the express terms of the trust document, the beneficiaries do not acquire their interests in Receiving Trust as a result of the exchange of their interests in Family Trust, but instead by reason of the exercise of the special trustee's existing authority to make distributions in further trust. In addition, the special trustee's modified administrative powers do not constitute an exchange by the beneficiaries.

Because no exchange has occurred, it is unnecessary to analyze whether the “materially different” standard has been satisfied.

Accordingly, based on the facts presented and the representations made, we conclude that the proposed transfer of assets from Trust 1 to Receiving Trust will not result in realization of gain or loss under § 61 or § 1001 by either trust or by any beneficiary.

Section 1015(a) provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

Section 1.1015-1(b) provides that property acquired by gift has a single uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by a transfer in trust (other than a transfer in trust by gift, bequest or devise), the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor under the law applicable to the year in which the transfer was made.

Section 1.1015-2(a)(2) provides that the principles in § 1.1015-1(b) concerning the uniform basis are applicable in determining basis of property where more than one person acquires an interest in property by transfer in trust.

In this case, because neither § 1001 nor § 61 applies to the proposed transaction, the basis of each asset in the hands of Receiving Trust will be the same as the basis of that asset in the hands of Trust 1 immediately before the distribution in further trust.

Under § 1223(2), the taxpayer’s holding period for property, however acquired, includes the period for which the property was held by any other person, if, for the purpose of determining gain or loss from a sale or exchange, the property has the same basis in whole or in part in the taxpayer’s hands as it would in the hands of the other person.

We conclude that under § 1223(2) the holding period of Receiving Trust in each asset received from Trust 1 will include the respective holding period of Trust 1 for each such asset.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative. The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James F. Hogan  
Branch Chief, Branch 4  
(Passthroughs & Special Industries)

Enclosures (2)

Copy for section 6110 purposes  
Copy of this letter

cc: